

**RATING ACTION COMMENTARY**

# **Fitch Affirms Seychelles at 'B'; Outlook Stable**

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Fitch Ratings - London - 28 May 2021: Fitch Ratings has affirmed Seychelles' Long-Term Foreign-Currency (LTFC) Issuer Default Rating (IDR) at 'B' with a Stable Outlook.

## **KEY RATING DRIVERS**

Seychelles' 'B' IDRs balance high public and external indebtedness, a small economy that is vulnerable to external shocks, and large structural current account deficits against strong governance, development and income per capita metrics relative to peer group medians and a good record of public debt reduction pre-pandemic.

The Stable Outlook reflects our expectation for tourism and economic growth to recover, a moderate near-term external commercial debt repayment schedule, and a good record of adherence to IMF programmes that supports multilateral financing.

We see signs of a recovery in tourist flows to Seychelles, which reopened its borders on 25 March. Visitor arrivals in April rebounded to 38% of the 2019 level, the highest since the onset of the Covid-19 pandemic. Fitch forecasts a gradual recovery of monthly tourist arrivals to 2019 levels by 3Q22, with total arrivals in 2021 at 41% of the 2019 level. The recovery is driven by non-core tourist markets and should be supported by the return of traditional European tourists as global travel restrictions ease.

Fitch forecasts real GDP to rebound to a 5% growth in 2021 (2020: -12.8%), driven by a robust resumption of tourist activity, favourable base effects, and supported by expansionary fiscal and monetary policies, and a very successful vaccination programme

(70% of the population with a first dose in mid-May). However, the recent rise in daily infection cases and deaths since end-April 2021 could result in further restrictions that could weigh on the recovery, while adverse developments in the pandemic globally also pose a downside risk.

The 2020 pandemic reversed a decade of fiscal consolidation and public debt reduction effort. The general government balance turned to a 18.9% of GDP deficit (B median: 7%) in 2020, from a 0.2% surplus in 2019, as income support and other social transfers increased current expenditure by 34%, and as tax revenues fell 14% with the contraction in tourism, especially in indirect taxes (-18%). The return of some tourism activity in 2021, larger grant receipts and a rebound in nominal GDP will shrink the fiscal deficit to 11.9% in 2021. Nominal fiscal expenditure should narrow only marginally as grant-financed capital expenditures partially offsets lower current expenditure from the phasing out of the flagship job retention scheme (2020: 6.6% of GDP) at end-March 2021.

Government debt/GDP increased 38pp in 2020 to 96% and we forecast only a slight fall in 2021 to 95.5% and further to 86% in 2022 due to economic recovery, rupee appreciation, and also to some fiscal consolidation. Foreign-currency debt comprised almost half of total debt at end-2020, increasing the vulnerability to external shocks, while short-term maturities accounted for a large 30% share of total debt, increasing interest-rate and roll-over risks.

Financing needs in 2020 were largely met through domestic sources (close to 85% of total), mainly through treasury bills, and SCR1.5 billion (7.5% of GDP) of three-, five- and seven-year bonds. For 2021, Fitch forecasts financing needs at 11.9% of GDP to be met primarily by domestic borrowing from banks (10.4% of GDP). Further programme disbursements from the IMF, World Bank and AFDB (worth roughly USD150 million) are currently being negotiated. In Fitch's view, the negotiation of a new IMF programme is unlikely to be problematic, given Seychelles' strong record of adherence to previous programmes.

The authorities are exploring the option of extending the average maturity of debt through a one-off exchange of treasury bills for longer-dated bonds through a voluntary market-based operation, although details are not yet available. The government has a manageable debt repayment schedule this year, and we understand from the authorities that this maturity extension operation is being designed as a liability management exercise.

Fitch's debt estimates exclude USD82 million (6.5% of GDP) of Air Seychelles debt, of which the government is negotiating USD72 million with the airline's bondholders to reduce to USD20 million. In May 2021, the government acquired Etihad's 40% stake in

Air Seychelles to become the sole owner, negotiating a reduction in Air Seychelles' liabilities to Etihad. In 2020, Air Seychelles, the state transport company, and airport authority were the main loss-making state-owned enterprises (SOEs), with total SOE non-guaranteed debt estimated by the government at 15% of GDP.

Fitch forecasts the current account deficit to narrow to 23% of GDP in 2021, after widening to 28% in 2020 (B median: 3.3%). The worsened current account deficit in 2020 and 2021 is primarily due to a slump in tourism receipts, but has remained large also due to a high import share of consumption and investment. Large estimation errors in the balance of payments raises uncertainty over the size of financing needs.

The current account deficit in 2020 was financed by multilateral concessional borrowing and inter-company loans, robust net foreign direct investment (FDI) flows amounting to 14.2% of GDP, as well as a large drawdown in private-sector assets. Net external debt jumped to 69% of GDP at end-2020 (end-2019: 40%), and should peak at 74% in 2021, while external debt service is moderate at 6.5% of current account external receipts in 2021, well below the 'B' current peer median (19.5%).

Despite external pressures in 2020 from tourist receipts being more than halved, there was a limited fall in Central Bank of Seychelles (CBS) official reserves of USD18.1 million to USD563 million (4.6 months of current external payments (CXP)) according to IFS data. We forecast CBS reserves to fall further to USD485 million in 2021 (3.7 months CXP) as adjustment to the external shock firms up. The sharp 55% depreciation of rupee against the US dollar at end-1Q20 to end-2020 has preserved foreign reserves, with the CBS intervening to ensure a smooth functioning of the foreign-exchange (FX) market.

ESG - Governance: Seychelles has an ESG Relevance Score (RS) of '5' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption, as is the case for all sovereigns. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model (SRM). Seychelles has a medium WBGI ranking at the 65th percentile reflecting a recent record of peaceful political transitions, a moderate level of rights for participation in the political process, moderate institutional capacity, established rule of law and a moderate level of corruption.

## **RATING SENSITIVITIES**

The main factors that could, individually or collectively, lead to positive rating action/upgrade are:

- Public finances: General government debt/GDP returning to a firm downward path over the medium term, for example, due to a sustained recovery in economic growth and a post-coronavirus-shock fiscal consolidation.

- External finances: A reduction in external vulnerabilities, for example, from a sustainable narrowing of the current account deficit, net of FDI, driven by a solid recovery in the tourism sector, supporting a higher reserve coverage ratio and reduction in net external indebtedness over the medium term.

The main factors that could, individually or collectively, lead to negative rating action/downgrade:

- External finances: More acute balance-of-payment pressures leading to a further fall in FX reserves and higher external debt ratios.

- Public finances: Failure to place general government debt/GDP on a firm downward path over the medium term, for example due to prolonged weakness in economic activity, greater structural fiscal loosening, or additional crystallisation of contingent liabilities.

## **SOVEREIGN RATING MODEL (SRM) AND QUALITATIVE OVERLAY (QO)**

Fitch's proprietary SRM assigns Seychelles a score equivalent to a rating of 'B+' on the LTFC IDR scale.

Fitch's sovereign rating committee adjusted the output from the SRM to arrive at the final LTFC IDR by applying its QO, relative to SRM data and output, as follows:

- External finances: -1 notch to reflect Seychelles' high gross and net external debt, large and persistent current account deficits, and very high dependence on tourism and fisheries for FX receipts, leaving it vulnerable to further shocks.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LTFC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

## **BEST/WORST CASE RATING SCENARIO**

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>.

## **KEY ASSUMPTIONS**

- Fitch assumes that the global economy develops in line with its Global Economic Outlook published on 17 March 2021.
- Fitch assumes that the global tourism industry experiences a gradual recovery over 2021-2022 following the pandemic shock.

## **REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING**

The principal sources of information used in the analysis are described in the Applicable Criteria.

## **ESG CONSIDERATIONS**

Seychelles has an ESG Relevance Score of 5 for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and a key rating driver with a high weight.

Seychelles has an ESG Relevance Score of 5 for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are therefore highly relevant to the rating and are a key rating driver with a high weight.

Seychelles has an ESG Relevance Score of 4 for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver.

Seychelles has an ESG Relevance Score of 4 for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Seychelles, as for all sovereigns.

Except for the matters discussed above, the highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit [www.fitchratings.com/esg](http://www.fitchratings.com/esg).

### RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Seychelles	LT IDR	B Rating Outlook Stable	Affirmed	B Rating Outlook Stable
●	ST IDR	B	Affirmed	B
●	LC LT IDR	B Rating Outlook Stable	Affirmed	B Rating Outlook Stable
●	LC ST IDR	B	Affirmed	B
●	Country Ceiling	BB-	Affirmed	BB-
● senior	LT	B	Affirmed	B

[VIEW ADDITIONAL RATING DETAILS](#)

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**APPLICABLE CRITERIA**

[Country Ceilings Criteria \(pub. 01 Jul 2020\)](#)

[Sovereign Rating Criteria \(pub. 26 Apr 2021\) \(including rating assumption sensitivity\)](#)

**APPLICABLE MODELS**

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

[Country Ceiling Model, v1.7.1 \(1\)](#)

[Debt Dynamics Model, v1.2.1 \(1\)](#)

[Macro-Prudential Indicator Model, v1.5.0 \(1\)](#)

[Sovereign Rating Model, v3.12.2 \(1\)](#)

**ADDITIONAL DISCLOSURES**

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Seychelles

UK Issued, EU Endorsed

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Sovereigns Africa Seychelles

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